S. HRG. 104–148

# ENTREPRENEURSHIP IN AMERICA: FOCUS ON CAPITAL FORMATION



## FIELD HEARING

BEFORE THE

## COMMITTEE ON SMALL BUSINESS UNITED STATES SENATE

ONE HUNDRED FOURTH CONGRESS

FIRST SESSION

APRIL 12, 1995

Printed for the use of the Committee on Small Business



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# ENTREPRENEURSHIP IN AMERICA: FOCUS ON CAPITAL FORMATION

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**WEDNESDAY, APRIL 12, 1995**

UNITED STATES SENATE,
COMMITTEE ON SMALL BUSINESS,
*Washington, D.C.*

The committee met, pursuant to notice, at 1:30 at Washington University Women's Center, 1 Brookings Drive, St. Louis, Missouri, the Honorable Christopher S. Bond (chairman of the committee) presiding.

Present: Senator Bond.

## OPENING STATEMENT OF THE HONORABLE CHRISTOPHER S. BOND, CHAIRMAN, COMMITTEE ON SMALL BUSINESS, AND A UNITED STATES SENATOR FROM MISSOURI

Chairman BOND. The hearing of the United States Senate Committee on Small Business will come to order. Good afternoon. We thank you very much for joining us today. It is a pleasure to be back in St. Louis and also to be at Washington University. I am very pleased to see Chancellor Danforth; and he expressed his regrets that he would not be able to stay, but we certainly appreciate the hospitality of the University, and we are delighted to see so many friends.

I might tell you that with me today is my staff director of the Small Business Committee in Washington, Louis Taylor. He and others of my staff here in St. Louis are joining us today and look forward—all of us look forward to having a chance to talk with many of you.

This is the first day of the series of hearings that we are holding around the country called Entrepreneurship in America. And we are focusing on a number of key issues facing small and growing businesses in our country. Witnesses this afternoon are small business owners, lenders, and investors who have come to share with us their ideas on the topic of great concern to all business, and that is access to capital.

When I talk to small business owners here in Missouri and across the country, one of the topics year-in and year-out is the uncertainty they face in obtaining financing to operate or expand their businesses. And as Chairman of the Committee on Small Business, I want to make sure that we respond to the needs of small businesses.

I am sure that many of you here well know that small businesses are the backbone of America and our economy. They employ 54 percent of the American work force. They generate some 50 percent of the gross domestic product. Over the past decade, for every person laid off by large corporations in this country, five new jobs will be created by small business. These new and growing small businesses need ready sources of capital to grow, to hire new employees, to continue to fuel our economic growth.

I firmly believe we cannot turn our back on this dynamic segment of our economy, and our government has an obligation to promote entrepreneurship. The Small Business Administration is the principal federal agency with a mission to make debt and equity capital available to all small business owners.

The 7(a) Business Loan Program guarantees small business loans that would not otherwise have been made. As many of you know, without the 7(a) guarantee, many banks would be reluctant to make longer term loans which are key if our nation's small businesses are going to grow and help revitalize our economy.

The SBIC, Small Business Investment Company, Program encourages private sector SBICs to provide equity and long-term debt financing to small businesses. Some of the best-known companies in America got help from an SBIC. You probably have heard of companies like Intel, Federal Express, Callaway Golf—the maker of the Big Bertha golf clubs.

A few weeks ago, the President and the SBA Administrator announced a proposed reorganization of SBA that would have significant implications for the 7(a) loan program. I would like to be able to ensure that our nation's small businesses have access to the essential programs and services of the Small Business Administration into the 21st century. I think we need to be ready to accept some budget cuts in the Small Business Administration in order to balance the budget. I sit on the Budget Committee as well, and I volunteered to that Committee a proposal to save hundreds of millions of dollars from the SBA budget over the next five years.

There are others who want to eliminate the SBA entirely; but I think there is an important mission to fulfill, and I will not support any budget cutting efforts that have the potential to cripple the ability of our small businesses to obtain the financing they need.

We are going to be holding hearings later this month on the 7(a) program, looking at options of restructuring financing to increase and ensure the availability of funds. The Committee will also be analyzing the SBIC program. We reviewed options that might enhance the public/private partnership so it can continue to grow without increasing demands on the federal budget.

I think we can be excited about the opportunity to improve the quality of life, the profitability of small and growing businesses and to give encouragement to the entrepreneurs of tomorrow. But we are here to learn from you who are actually doing the work and who are in the field. Your testimony is vitally important. The best ideas, we always find, come from the people who are actually doing the work, who are here in the field and not necessarily those who are in Washington talking to us all the time. I applaud and appreciate your being here and your participation in this hearing. I look forward to hearing your views and comments, so we can find ways to work together to promote the spirit of Entrepreneurship in America.

We have three panels today, and I would like to invite the first panel to come forward. James F. O'Donnell, Chairman of Capital for Business, Inc.; William M. Zielonko, Senior Vice President of Retail Banking of the Boatmen's National Bank of St. Louis; and Dennis G. Coleman, Executive Director of the St. Louis County Economic Development Council.

Gentlemen, your entire statements will be included as a part of the record. The ones that I have received, I have had an opportunity to review thoroughly. We will take all of these written records back to Washington for Committees and staffs to review. Because we do have a lot of people today, we are going to ask that you keep your oral testimony to five minutes and if you would summarize the major findings.

Normally we have a very sophisticated timing system. It has a green light when you get started; and with one minute to go, a yellow light comes on; when the five minutes are up, we have a red light. However, we have not been able to keep up with technology, and the machine is down. So Mr. Goldfarb will hold up a high-tech sign over here which says one minute to go, and if you could keep your testimony within that time frame; I would very much appreciate it. Let's start with Mr. O'Donnell.

## STATEMENT OF JAMES F. O'DONNELL, CHAIRMAN, CAPITAL FOR BUSINESS, INC., ST. LOUIS, MISSOURI

Mr. O'DONNELL. Mr. Chairman, I appreciate the opportunity to testify today. I am pleased to be able to share my perspective on capital formation and specifically the role of the Small Business Investment Company program and its impact on small business in our state. I am testifying today in my capacity as Chairman of Capital For Business, Inc., and as a member of the Executive Committee of the Board of Governors of the National Association of Small Business Investment Companies which is the professional trade association which represents the SBIC industry.

Capital For Business is a venture capital investor and fund manager of two SBICs specializing in management buyouts, acquisitions and mergers, and expansions of privately held companies. Headquartered here in St. Louis, Capital For Business manages CFB Venture Fund I, Inc., a $17 million corporate SBIC and CFB Venture Fund II, a $30 million SBIC limited partnership.

In general, CFB investments are structured as preferred stock or subordinated debt with common stock warrants for an equity participation. Our investments rely upon current return in the form of a cash dividend or interest payment, an important portion of our total return. We focus our investments primarily in Missouri and the nearby Midwestern states.

I joined Capital For Business in 1987 as president and became chairman in 1990. I have over 20 years of experience as a business manager working with middle market companies and have been affiliated with Commerce Bancshares, CFB's parent and largest investor, for more than 12 years.

Today, I would like to address several key issues regarding the SBIC program and its impact on capital formation efforts of small businesses. First, it is important to understand why Congress created our unique public/private partnership, the Small Business Investment Company.

The SBIC program found its beginning in a Federal Reserve study conducted in the mid-'50s. The study concluded that sources of long-term loans and equity financing for small businesses were inadequate. The Congress responded to the Federal Reserve Board's observations by creating the Small Business Investment Act of 1958. The provisions of this Act created the Small Business Investment Company program.

Over the 36-year history of the program, SBICs have invested close to $12 billion in 100,000 small businesses around the country including, of course, Missouri. Mr. Chairman, in 1994 alone, small businesses received approximately $1 billion in SBIC financing which was about a quarter of the total equity financing done in the country.

Current trends in the capital markets, however, have nearly shut out the ability of small businesses to raise long-term patient capital. This funding gap for small companies remains particularly acute because these kinds of businesses are not high-technology-based companies or they are not located in the strongholds of equity investments such as Boston, New York, Chicago, or California.

For 36 years, SBICs have worked to fill that gap. Close to 78 percent of the small businesses funded by SBICs are nontechnology-based businesses. You quoted already the SBIC participation in well-known national companies that have grown and created jobs and paid federal income taxes. But there are also stories of hundreds of thousands of "Main Street, USA" businesses financed by SBICs that are not as prominent. It is this story that truly illustrates the impact SBIC investments can have.

Local SBIC investments include technology-based companies like CITATION Computer Systems in St. Louis and also basic metal cutting companies like Steel Manufacturing & Warehouse Company in Kansas City. CFB I, our original SBIC, invested approximately $900,000 in CITATION mostly between 1983 to 1988. The amount of each investment round making up the $900,000 ranged from as little as $100,000 up to $250,000, amounts which would try the patience of larger, non-SBIC type equity investors.

In 1992, CITATION successfully completed an initial public offering raising over $6 million. From $3 million in revenues back in '83 and only 36 jobs, CITATION today has $23 million in revenues and employs 212 people. I think CITATION is truly a SBIC success story in Missouri. Steel Manufacturing & Warehouse Company is a metal cutting and slicing business which was unable to grow because of a lack of capital. In 1993, Steel had revenues of $9 million. CFB II, our new venture partnership, invested $1 million in Steel, and within two years the company projects $15 million in revenues. Steel employs about 41 people in Kansas City.

Most of these kinds of companies do not get the attention of the investment banking community because commissions would be too small for firms like this. Borrowing from local banks is also difficult because of collateral concerns or under-capitalization on the balance sheets. These companies require smaller amounts and usually longer repayments to be bankable. They need, in other words, the kind of investments that only SBICs would be willing to make.

In 1989, the SBIC industry recognized the fact that in spite of the tremendous benefits of the program, there were some shortcomings in its operations. And working closely with the SBA and members of Congress, our industry group helped overhaul the program. The new, revamped SBIC program was signed into law in September of 1992, and the regulations implementing the laws became effective in April 1994.

The fundamental problems of the program, I think, have been addressed and are being corrected. Included in the overhaul were many changes made to both the costs and the risk of the program to the federal government. Also included in the legislation was creation of the new funding mechanism for small business investing which we have called the Participating Security.

Since the new program officially began 11 months ago, 43 new SBICs have been licensed including two new Missouri SBICs. These 43 SBICs have raised $700 million in private capital representing more private capital entering the program in that one year than in the last 10 years combined. I am also pleased to report that on February 22nd of this year, the first funding using the new Participating Securities allowed nine SBICs to obtain $73 million from the capital market for investments in small businesses. This funding, coupled with private capital from the participating SBICs, made available over $100 million immediately for small business investment.

More clearly, the Participating Security enables SBICs to invest in riskier, smaller businesses by deferring a portion of the interest to the back end of the deal. In exchange for its deferral, the Government receives participation in the profits.

Mr. Chairman, our industry recognizes and appreciates the environment in which you and your colleagues of Congress are working. The calls to reduce the deficit, decrease the size of government, and balance the budget are loud, and we hear them in the industry. But the overwhelming expansion of the program and the demand for leverage by SBICs has placed enormous pressure on current appropriation levels, and the funding levels required to meet the demand of licensees dramatically exceeds the current appropriations.

I will close by saying, Mr. Chairman, the provisions of the rescission bill passed in the Senate which would pare the SBIC appropriation by $15 million will certainly cripple the ability of SBICs in the short run to invest in small companies. We urge you to consider the impact of this amendment and how it will help stall the growth of small businesses in Missouri, in the Midwest, and around the country.

We ask for your help, but we offer our help also. In this environment of fiscal restraint, we believe it is critical that we continue to explore all possible means of reducing the role of the federal government and budgetary costs to the federal government of the SBIC program without undermining the tremendous contribution the program makes to the U.S. economy. We, as an industry, and me personally as an SBIC manager, are committed to studying every possible means of reducing the costs of the program to the American taxpayer.

We believe it is possible to design a program that will reduce or eliminate the need for direct, annual appropriations while providing a consistent source of funding to enable SBICs to continue providing long-term patient capital.

We will be pleased to present our research on this privatization plan to you and members of the committee when completed. In the meantime, we urge your support of current funding levels for the program.

[The prepared statement of Mr. O'Donnell follows:]

## Statement
## of
## James F. O'Donnell

## Chairman,
## Capital For Business, Inc.
## St. Louis, Missouri

I appreciate the opportunity to testify today. I'm pleased to be able to share my perspective on capital formation, and specifically, the role of the Small Business Investment Company Program and its impact on small business in our state.

I am testifying today in my capacity as Chairman of Capital For Business, Inc., and as a member of the Executive Committee of the Board of Governors of the National Association of Small Business Investment Companies, the professional trade association representing the SBIC industry.

Capital For Business, Inc. is a venture capital investor and fund manager of two SBIC's specializing in management buyouts, acquisitions and mergers, and expansion of privately held mid-size companies. Headquartered here in St. Louis, Capital For Business manages CFB Venture Fund I, Inc., a $17 million corporate SBIC, and CFB Venture Fund II, Inc., a $30 million SBIC limited partnership.

In general, CFB investments are structured as preferred stock or subordinated debt with common stock warrants for an equity participation. Our investments rely upon current return in the form of cash dividend or interest as an important portion of total return. We focus our investments primarily in Missouri and the nearby Midwestern states.

I joined Capital For Business in 1987 as president and became chairman in 1990. I have over twenty years experience as a business manager working with middle market companies and have been affiliated with Commerce Bancshares, Inc., CFB's parent and largest investor, for more than twelve years.

Today, I'd like to address several key issues regarding the SBIC program and its impact on the capital formation efforts of small business.

First, it is important to understand why Congress created our unique public/private partnership, the Small Business Investment Company.

The SBIC program found its beginning in a Federal Reserve study conducted in the mid-1950's. The study concluded that sources of long-term loans and equity financing for small businesses were sorely inadequate. The Congress responded to the Federal Reserve Board's observations with the Small Business Investment Act of 1958. Provisions of this Act created the Small Business Investment Company program.

Over the 36-year history of the program, SBICs have invested close to $12 billion in 100,000 small businesses around the country, including Missouri. Mr. Chairman, in 1994 alone, small businesses received approximately $1 billion in SBIC financing.

Current trends in the capital markets have nearly shut out the ability of small businesses to raise long-term, patient capital. This funding gap for small growth companies remains acute--particularly for businesses that are not high-technology-based or located in the venture capital strongholds of Boston, New York, Chicago, and California.

For thirty-six years, SBICs have worked to fill that gap. Close to 78% of small businesses funded by SBICs are non-technology-based businesses. The story of SBIC participation in the start-up of Federal Express, Apple, and Intel are familiar to many. The story of the hundreds of thousands of "Main Street, USA" businesses financed by SBICs is not. And it is this story that truly illustrates the impact of SBIC investments.

SBIC investments include technology based companies like CITATION Computer Systems in St. Louis and basic metal cutters like Steel Manufacturing & Warehouse Company in Kansas City. CFB I, our original SBIC, invested a total of over $900,000 in CITATION from 1983 through 1988. The amount of each investment round making up the $900,000 ranged from $100,000 to $250,000, an amount which would try the patience of larger, non-SBIC venture firms. In 1992, CITATION successfully completed an initial public offering, raising over $6,000,000. From $3,000,000 in revenues and 36 jobs in 1983 to $23,000,000 in revenues and 212 jobs in 1995, CITATION clearly is a Missouri SBIC success story. Steel Manufacturing & Warehouse Company was a metal cutting business unable to grow due to a lack of capital. In 1993, Steel had revenues of $9,000,000. CFB II, our newest SBIC, invested $1,000,000 in Steel and two years later, the company projects revenues of $15,000,000 and employs 41 people.

Most of these companies cannot get the attention of the investment banking community because commissions for the firms would be far too small. Borrowing by their local banks is either insufficient or impossible to find because small companies often lack hard assets for collateral and because their capital needs are relatively small and require a longer-term repayment. They need the investments that only an SBIC would be willing to make.

In 1989, the SBIC industry recognized the fact that in spite of the tremendous benefits the program had already generated for the U.S. economy, there were shortcomings in the operations of the program. Working closely with the U.S. Small Business Administration and members of Congress, we helped overhaul the SBIC program.

The new, revamped SBIC program was signed into law in September of 1992 and the regulations implementing the law became effective in April of 1994. The fundamental problems of the program were addressed and corrected. Included in the overhaul were many changes made to both the cost and the risk of the program to the Federal government. Also included in the legislation was the creation of a new funding mechanism for small business investing which we call the Participating Security.

Since the new program officially began eleven months ago, 43 new SBICs have been licensed, including two with Missouri roots. These 43 SBICs have raised $700 million in private capital, representing more private capital entering the SBIC program in one year than in the last ten years combined. I'm also pleased to report that on February 22, 1995, the first funding using the new Participating Securities allowed nine SBICs to obtain $73 million from the capital markets for investment in small businesses. This funding, coupled with private capital from the participating SBICs made available over $100 million for investing into small businesses immediately.

A colleague of mine in a Kansas-based SBIC is already investing his proceeds from this landmark funding in seven early-stage companies here in the midwest. I stress early-stage because it is the Participating Security that permits him to provide the long-term patient capital those seven companies will need to grow strong, create jobs, create wealth within their communities, and general tax revenues.

More clearly, the Participating Security enables SBICs to invest in riskier, smaller businesses by deferring a portion of the interest which SBICs pay to the Federal government in the earlier years of the SBIC's life. In exchange for the deferral, the government receives a participation in the profits of the SBIC, thus creating the strong possibility that the SBIC program may cost much less in the near future and may actually cost the Federal government nothing. We believe the new SBIC program will generate a profit for the government in the future--in addition to creating jobs, technologies, services, and tax dollars to strengthen the U.S. economy.

Mr. Chairman, our industry recognizes and appreciates the environment in which you and your colleagues in the Congress are working. The calls to reduce the deficit, decrease the size of government, and balance the budget are loud. We hear them too.

The overwhelming expansion of the SBIC program and of the demand for leverage by SBICs from the Federal government has placed enormous pressure on current appropriation levels. The funding levels required to meet the demand by licensees, and the needs of small businesses themselves, dramatically exceeds the current appropriations.

Mr. Chairman, the provisions in the recision bill passed in the Senate which would pare the SBIC appropriation by $15 million will certainly cripple the ability of SBICs to invest in small companies. We urge you to consider the impact of this amendment and how it will stall the growth of small businesses in Missouri, the Midwest, and around the country.

We ask for your help now and also offer ours. In this current environment of fiscal restraint, we believe it is critical that we continue to explore all possible means of reducing the role of the Federal government and budgetary cost to the Federal government of the SBIC program--without undermining the tremendous contribution the program makes to the U.S. economy. We, as an industry, and me personally as an SBIC professional, are committed to studying every possible means of reducing the cost of the SBIC program to the American taxpayer.

We believe that it is possible to design a program that would reduce or eliminate the need for direct, annual appropriations while providing a consistent source of funding from the capital markets to enable SBICs to continue providing long-term patient capital to small growth companies. We will be pleased to present our research on this privatization plan to you and members of the Committee when completed. In the meantime, we urge your support of current and future funding levels for the SBA and the SBIC program.

In closing, I'd like to call your attention to a study conducted by Arthur Andersen's Enterprise Group and National Small Business United in 1993. Thirty percent of the survey's respondents claimed that access to capital is a significant challenge to the growth and survival of their small and mid-sized companies. In preparation for the upcoming White House Conference on Small Business, SBA's Office of Advocacy recently conducted a study called, "Small Business and Entrepreneurship in the Twenty-First Century." Various focus groups were called together to discuss the obstacles and opportunities that small businesses will face in the year 2005. The discussions were provocative. In each focus group, they discussed repeatedly the current and future ability of small business owners and entrepreneurs to gain access to the capital they need for growth and expansion.

The SBIC program has served the small business community well over its 36-year history. Today's SBICs are better managed and better capitalized. They operate in a more reasonable regulatory environment and are able to fill the capital needs of small business. Most importantly, today's SBICs are committed to invest in and work with America's small growth companies to help them now and well into the future.

Again, thank you for this unique opportunity to share information about the SBIC program. We have appreciated your leadership role as Chairman of the Senate Committee on Small Business and look forward to working more closely with you to make the new SBIC program better and American small businesses stronger. Thank you and I submit this testimony for the official record of the Committee.

Chairman BOND. Thank you, Mr. O'Donnell. I have written to the Committee on Appropriations, and Subcommittee Chairmen, objecting to that based on information that we received from the SBA after the action was taken, and we hope that we can use the information that you have provided and they have provided to turn that around.

Let me turn now to Mr. Zielonko.

**STATEMENT OF WILLIAM M. ZIELONKO, SENIOR VICE PRESIDENT, THE BOATMEN'S NATIONAL BANK OF ST. LOUIS, ST. LOUIS, MISSOURI**

Mr. ZIELONKO. Thank you for inviting us to be with you today, Senator Bond. Boatmen's is very active in all aspects of small business banking, and we are pleased to share some of our experiences with you.

Through our small business unit, which we call business banking, Boatmen's has a depth of experience in SBA lending. We rank first in SBA loans in Eastern Missouri with over $9 million loaned in the past two years. We made 78 SBA loans from '92 to '94 and have also made one of the first LowDoc loans in the area. We are one of 19 banks nationally that are participating in the FasTrak pilot program, and we have 50 local lenders trained under the Certified Lender Program.

We are also active in small business funding through the Civic Ventures Investment Fund, a Specialized Small Business Investment Company or SSBIC whose mission is to help socially or economically disadvantaged entrepreneurs and their communities by helping them create successful business ventures. Boatmen's organized and is a lead investor in the Fund which uses private capital and SBA funding to provide a combination of equity financing and loans for disadvantaged small businesses and minority entrepreneurs while providing a reasonable return for the business investing in the Fund.

As successful businesses are built, new jobs created will stabilize communities, increase the tax base, and influence other positive outcomes. Although financial return is secondary to the community benefit, the rate of return for investors is expected to be 18 percent. We bring this to your attention because we believe it is a successful example of private industry filling a social need with minimal assistance from the government. To date, we have raised over $3 million from private investors.

We consider the SBA an important partner in the delivery of financing to small business. We are pleased to report that the St. Louis District Office is responsive and has been highly visible in supporting efforts such as Small Business Week; the Small Business Development Center with St. Louis University; and SCORE, Service Corps of Retired Executives. In addition, the LowDoc and FasTrak programs represent important new developments for small business owners, while the 7(a) program serves more established businesses.

But we feel that while the 7(a) program has worked successfully for many loans, it can be improved by reducing paperwork. As bankers, we lend money every day. We have invested heavily in developing streamlined procedures and advanced technologies and are experienced in underwriting, processing and funding loans quickly and efficiently. We know how to deliver loans, and we find that excessive paperwork strangles this efficiency. Banks are forced to spend unnecessary resources on SBA paperwork, and small business owners wait an unnecessarily long time because of the requirements.

We recommend that the SBA allow banks to leverage their internal investments by linking SBA documents to their own remote document printing technologies. Banks should also be able to generate documents themselves, as in the FasTrak pilot program, for 7(a) and 504 loans.

Reducing paperwork makes us more efficient and also saves the government money. Banks want to incorporate SBA loans into their normal lending process. If we have to establish a separate department to handle unique paperwork, we cannot make a profit.

Paperwork is the first major issue facing borrowers and lenders; the lack of collateral is the second. We do cash flow analysis, we do credit underwriting; but we cannot compensate for lack of collateral. The SBA loan guarantees are extremely important to filling this gap.

Most small businesses, especially service providers, have no hard dollar assets. Therefore, it is even more difficult to get financing, especially if the business is a start-up. The SBA loan guarantee remains critical. However, we feel that guarantees could be reduced, especially if we can do our own documentation.

We have a few other recommendations. We suggest that SBA eliminate IRS tax verification for loans under $100,000 dollars. This process can delay a loan for 10 days to several weeks. We also ask that the SBA recognize that the St. Louis area is one market that spans two states. Illinois businesses that use Missouri banks are forced to go to Springfield, Illinois SBA offices. We recommend that the bank's location rather than the borrower's location be the prime determinant in which an SBA office is used. We understand this is under consideration.

Finally, we ask that you recognize the caps on rates and fees, combined with a proposed bank fee of 30 basis points, will place a severe squeeze on the profitability of small loans. When developing fees, guarantees and pricing caps, the government should differentiate between programs targeted to smaller loan requests and the general 7(a) loans. It should also differentiate between loans which were sold on the secondary market and the less risky and more profitable loans that are held in a bank's portfolio to maturity. In addition, by raising fees, this makes it more difficult for banks to maintain our current level of commitment to SBA loans.

We are appreciative of the benefits the SBA guarantees offer to small business owners. We would like to make more small business loans. However, we are not in the business for transactional purposes. Our interests lie in long-term relationships with business owners. We are a portfolio lender, and we want to help businesses move out of the SBA products into regular loan products and long-term prosperity, building enough capital so SBA guarantees are not necessary.

Previously, the SBA was often used for loans banks did not want to make. Now, by helping businesses meet collateral criteria, the SBA is a critical partner for many small businesses.

Thank you for the opportunity to present our views.

Chairman BOND. Thank you very much. And now we will turn to Mr. Coleman.

### STATEMENT OF DENNIS G. COLEMAN, EXECUTIVE DIRECTOR, ECONOMIC COUNCIL OF ST. LOUIS COUNTY, ST. LOUIS, MISSOURI

Mr. COLEMAN. Senator, good afternoon and thank you. It is an honor to be here. My name is Denny Coleman, Executive Director of the Economic Council of St. Louis County, a not-for-profit economic development agency whose mission is to create high quality business and employment opportunities for long-term, diversified economic growth throughout St. Louis County and the St. Louis region as well. My agency oversees a wide variety of regional economic development programs, including the World Trade Center St. Louis, the St. Louis Defense Adjustment Program, the Critical Technologies Partnership in conjunction with Civic Progress, and many small business financing programs.

One of our organization and the region's most successful lending programs over the past decade has been the SBA 504 loan program. The closure of the SBA district office in St. Louis that has been discussed, which is the largest metropolitan area in the Midwest Region 7, will be highly counterproductive for many reasons.

St. Louis County is currently the ninth most active lender in the nation out of approximately 375 nationwide CDCs. When the County is combined with St. Louis City, our region ranks among the top five in the nation. Furthermore, the St. Louis district SBA office is number one in LowDoc loan processing in Midwest Region 7. The St. Louis district office also has the largest portfolio in Region 7 with over 3,500 loans worth nearly $400 million, figures which also represent the largest loan volume in the Midwest.

In the first six months of the current fiscal year, the St. Louis district office has acted on 473 loans and expects to reach 1,000 loans this year. Within our organization alone, 1994 was a record year in which we disbursed 34 SBA 504 loans, which represented over $30 million in new investment in St. Louis County and nearly 500 jobs. To date, our organization has disbursed over 675 loans totalling $1.1 billion with a default rate of 1.3 percent.

Other strengths for St. Louis include its recent selection as a site for women and minorities prequalification pilot loan programs as well as its designation as one of 11 cities nationwide to receive an Export Assistance Center.

In focusing on specifics of the 504 program, two of its most noteworthy aspects are its low-loss, low-cost rates and its gap-financing features. The 504's actual federal appropriation is only 0.57 percent of the loan guarantee amount. Thus, the appropriation for this year will result in nearly $1.5 billion in actual loans, which will, in turn, result in significant new job creation. In fact, over 400,000 jobs have been created and documented as a result of this program since its inception.

The gap-financing benefit of the 504 program means, in its most basic and important sense, that the vast majority of 504 borrowers could not have financed their fixed-asset projects if it were not for the existence of the 504. St. Louis County alone can document numerous borrowers whose businesses have thrived after receiving a 504 loan but whose growth was dependent on it.

A prime example of this is Bock Pharmacal, a family-owned small business whose utilization of the 504 program was a catalyst for tremendous growth. Bock needed to expand its pharmaceutical sales and distribution business and, through the 504 program, was able to construct a building in St. Louis County with a down payment of only 10 percent of the total project cost of $900,000. Through this program, when the loan was disbursed in 1986, Bock had net revenues of $3.2 million and 40 employees. At the end of last year, Bock's revenues had grown to over $71 million and now employs 350 people.

Bock has also used the program to help purchase a building to accomodate the growth of its spinoff company, Highland Packaging. At the time of the loan application, the company had 22 employees and net revenues of $5.2 million. Today, Highland employs 100 people and had year-end revenues of $23 million. Bock Pharmacal has been extremely vocal in its support of the 504 loan program and the incredible role it played in the future success of the company. And this is, as I said, one of only many examples we could offer.

In respect to the Small Business Development Centers, I feel that these important examples of public/private partnerships should be retained and should have appropriate coordination with economic development organizations in their respective regions. The SBDCs would be a perfect complement to our many small business development services provided by economic development organizations.

In addition, I would suggest that the SBDCs be not only allowed, but perhaps even mandated, to charge a service fee where participating companies match part of the dollars put up by the centers. Such a schedule would lower government cost, leverage resources better, and assure more relevance since businesses would be paying for a portion of the service provided.

Our organization has enjoyed tremendous success with a similar prototype we implemented through our region's Defense Adjustment Program. This program was called our Management Assistance and Technology Transfer project or MATT. It helps defense companies' transition to commercial marketplaces. Business owners which participated in the program were mandated to match our investment dollars up to 50 percent. To date, MATT has worked with companies representing over 5,800 St. Louis employees. Companies involved in the program have ranged in size from 7 to 2,500 employees, in age from 2- to 100-years old and in products from machine parts to highly sophisticated guidance systems. We believe that the success of the MATT program could be duplicated to SBDC type operations throughout the country.

The 504 loan program is of great value to our area's small businesses and the entire St. Louis region. Its elimination would hurt growing small businesses and, as a result, would cost our region hundreds of thousands of jobs each year. In addition, the St. Louis office's consolidation with Kansas City would leave a great void in our region that would be difficult to fill. Kansas City is a business day's travel from St. Louis, making face-to-face business dealings difficult and time-consuming for small business people for whom time is money. Eliminating such a successful program and closing such an important office are not the best solutions.

In conclusion, we recommend the continuation of the SBA 504 loan program and the continued operation of the St. Louis district office. We also urge continuation of the SBDC centers, but recommend their placement within local economic development organizations and that a service charge or fee schedule be implemented in which participating companies match the dollars put up by the centers. Thank you very much.

Chairman BOND. Thank you very much, Mr. Coleman. I might note that we have requested information from the SBA on justification for their proposal. We are going to take a very careful look at it and look rather skeptically at it. Let me ask you gentlemen to comment on some testimony we are going to receive from a very distinguished witness later on who voiced many small business problems, including the huge budget deficit which is draining funds from the private capital market, high tax rates, and the burden of regulations. Certainly the burden of regulations is one of the things that we are looking at. He goes on to raise the question that since less than 1 percent of the millions of small companies ever receive an SBA loan and the other 99 percent have to pay taxes to support them, given the deficits we have, how would you justify the continuation of the SBA?

Now, let's start with you, Mr. O'Donnell. And you all have addressed that, but in this particular context.

Mr. O'DONNELL. Well, I think statistically what was said might be true. There are many, many, small businesses; but a lot of these businesses are one-person businesses. When a business grows to a medium stage, it needs some additional bootstrapping and financial support, and that is where the SBA comes in to get it over that hurdle; and perhaps later the SBIC program comes in to further expand its growth.

Very large companies are not creating jobs. The Fortune 500 has a net job loss that is highly material in the last 10 years. Jobs are being created out of small businesses. I hope they get spared. To take the number of SBA financed businesses in the numerator, and the total number of businesses in the denominator, does not work fairly. It skews the perception.

Chairman BOND. Mr. Zielonko.

Mr. ZIELONKO. One of the ways that we could maybe broaden the universe would be to lessen an amount of guarantees on a particular loan. And as I said, we are willing to accept this in the banking industry given that we have some trade-offs in the expansions to float these loans.

The second thing I think we should point out is that the government is not loaning these funds directly to the borrower. The banks are using their money to make these investments. And we are just asking that the government part of the program be involved, much like an insurance policy, to help us underwrite the collateral risk involved in the start-up of—in start-up situations.

Chairman BOND. Mr. Coleman?

Mr. COLEMAN. I would like to speak first to the regulatory issue of your question of small and medium-sized businesses that we talked with. If we are having regulatory problems with one type or another, it is typically with the changing nature—constant changing nature of regulations. I think most of them would desire that regulations that are in place stay the same so they could play with the same set of rules year to year to year rather than having a constantly changing landscape. That is more problematic to them, I think, than other issues.

On the financing aspect of this program versus many others in the federal budget, I would just say that I would hope that some element of looking at the leverage that is created by the variety of different cuts that they proposed in the federal budget be appreciated and looked at, because this program in particular leverages such substantial amounts of private sector participation on the lending side as well as investment on the private business side. And whatever expenditure there is, there is a significant amount of payoff, a very direct payoff, in investment in American businesses.

Chairman BOND. Mr. O'Donnell, you do not believe that the private sector funding would be available absent the SBA type programs?

Mr. O'DONNELL. For larger companies where the markets are efficient, there would be private sector funding. But for smaller businesses that need smaller amounts of money, more patient capital, there would be a real problem.

Chairman BOND. You said that you are going to share with us the outline of the programs to reduce or eliminate the need for appropriations. Do you have any suggestions for us or thoughts on the direction that is going to be going?

Mr. O'DONNELL. As far as the SBIC program, we are putting together a plan right now to privatize that program. We think that a federal agency similar to Fannie Mae would be very feasible and very practical for SBICs. We are going to need some time to do that. It cannot be done overnight; it would possibly take us a year to two years.

In the interim, we need to prevent the carpet from being pulled out from under us. We need to be able to continue our funding while we execute the plan that I have described. We expect to have that plan to you and the House Committee within the next few weeks.

Chairman BOND. We will be looking forward to receiving that. Mr. Zielonko, you talked about reducing the guarantee at the 50 percent. Now, under your guarantee, are you saying that any losses would be shared fifty-fifty between the lender and the government, or are you saying that that 50 percent—are you willing to take the first 50 percent?

Mr. ZIELONKO. I think we are. Under the new FasTrak program, the guarantee would be 50 percent. And part of the parameters of that are that we participate in any foreclosure proceedings, and we are very confident in our underwriting capability. All of our loans that are non-SBA program, we take 100 percent. So we would be willing to do that.

Chairman BOND. Now, this is one of the areas we are looking at. More and more, lenders are telling us that if they can do their own paperwork and we put them at the front of the line in terms of risk, they are willing to step up. Let me ask you, have you looked at the fee schedule that has been proposed in SBA reorganization which will raise the fees and increase the costs of the 7(a) lending program? Will this have a negative impact on your ability to participate in it?

Mr. ZIELONKO. It very definitely would, mainly because these small loans—I mean, it costs me just as much to make a $1 million loan as it does to make a $25,000 loan. That is how our systems are set up.

If we have to give away additional parts of the profit, it makes it less advantageous to us; and, of course, we have higher risks involved. So I would see it would have a big detriment to the growth of the program for small businesses.

Chairman BOND. Mr. Coleman, do you have any thoughts on the new proposal for increasing the fees, particularly on the 7(a) loan program?

Mr. COLEMAN. We do not deal directly with the 7(a); but I would agree with Mr. Zielonko that the fees can be detrimental, particularly at the smaller end of the spectrum, for the businesses. We have to be cognizant of the fact that we are dealing with people who do not have a lot of cash up front; that is why they are still small.

Chairman BOND. You mentioned the SBDC and the charges that you would propose to make. I have talked to some of the people who benefited from the SBDC program, and very often it appears to me that one of the reasons they are working with the SBDCs is they do not have the resources to get that funding. And does that concern you? Would a back-end fee or an equity participation, or minor equity participation, suffice?

Mr. COLEMAN. There are numerous ways that that could be structured. The principal issue here is that to have the full attention of the business and to make sure that from the service delivery perspective we are being relevant to the business, some type of charge or fee that is associated with that service is important.

I might add that I am also a member of the statewide SBDC Board. And we are not just talking about experience in St. Louis; but the entire statewide program, I think, could, in fact, benefit by that type of approach. We have seen businesses, who do pay something into the program. The attention of the CEOs to that service and the quality of the service they are getting has to be much greater because they are paying something for that service.

That is the benefit to us as an agency, because I know that the services we are providing are relevant because the companies are willing to pay for them.

Chairman BOND. That is a principle I used to apply when I used to give speeches for honorarium fees. I found that people paid attention a lot more to what I was saying when I collected a fee for it. Maybe that would have the beneficial impact. [Laughter]

Well, Gentlemen, we very much appreciate your testimony. There will be a lot of other testimony today; we invite you to stay around for it. And should you have other thoughts on the issues that we raise, certainly we would like to have further suggestions that you think of; and if you have any comments, we would welcome any further written views or ideas that you have. And that obviously goes for the other members of our audience today. Thank you very much for your time and the efforts you put in in making such fine presentations.

Next I would like to call panel number two. Tessa Greenspan, President of Farmer's Market; Ramon Gallardo, Founder of Casa Gallardo; and Virginia Kirkpatrick, President and Owner of the CVK Personnel Management and Training Specialists.

Ms. Greenspan, could you begin, please.

**STATEMENT OF TESSA GREENSPAN, PRESIDENT, SAPPINGTON FARMER'S MARKET, ST. LOUIS, MISSOURI**

Ms. GREENSPAN. Well, my concern was that you are eliminating or did want to eliminate Small Business Development Centers. Without the help from Small Business Development Centers and St. Louis University, I would not have been able to put my business plan together. I submitted my business plan to 10 banks; all of them approved the loan. With the help from the Small Business Development Center, I applied for and got a $400,000 loan from SBA.

Mr. CHAIRMAN. Would you mind pulling that microphone just a little closer to you?

Ms. GREENSPAN. I now employ 62 people with projected sales of $700,000 for the first year. Now, this is for my store. I am just one of many that this program helps. To me, it is quite obvious that this program pays for its own in two ways: employing people and taxes generated.

The impact study done by SBDC, Small Business Development Center, said that for every federal dollar invested in the program over $7 in increased tax revenues are generated. A cut of $366 million for the SBDC program in five years would yield over $2 million in lost taxes. Why would the government eliminate a program that pays for itself, creates jobs, and generates revenue?

[The prepared statement of Ms. Greenspan follows:]

SAPPINGTON
Farmer's Market

11520 GRAVOIS RD.
ST. LOUIS, MISSOURI 63126
(314) 843 5367
FAX (314) 843-1640

March 31, 1995

Senator Christopher S. Bond
Small Business Development Center
8000 Maryland
St. Louis, MO 63105

Dear Senator:

I am writing to express my concern for the total elimination of federal funding for the SBDC program in a document from Representative John Kasich's office entitled "Illustrative Republican Spending Cuts" dated March 16, 1995.

Without the help from Ginni Campbell of SBDC I would not have been able to put my business plan together.

With the help from SBDC I applied for and got a $400,000.00 loan from SBA and now employ 62 people with projected sales of $7,000,000.00 the first year.

I am just one of many that this program helps.

It is quite obvious that this program pays for itself in two ways; employing people and taxes generated.

The SBDC is not a bureaucratic program; it has local administration and control.

In 1992, consultation with SBDC resulted in the creation of 2,574 new jobs.

Why would the government eliminate a program that pays for itself, creates jobs and generates revenue?

Please respond to this question.

Thank you,

Tessa Greenspan

Tessa Greenspan
President

TG/djl

Chairman BOND. Thank you very much. Mr. Gallardo.

## STATEMENT OF RAMON A. GALLARDO, FOUNDER, CASA GALLARDO RESTAURANTS, ST. LOUIS, MISSOURI

Mr. GALLARDO. Mr. Chairman, I strongly appreciate the opportunity to make the following statement in regard to the 7(a) program. In 1974, I approached several loan officers of numerous lending institutions in an effort to obtain financing to open a restaurant.

I had been working in the restaurant industry for the previous 13 years, and I felt that I had the capability of going into business for myself.

I prepared a business program which I presented to a number of banks, and they all thought I had a great idea, my presentation was wonderful, and the numbers made sense, but did not think they could lend me the money. And, again, after turndowns and many frustrating experiences, the Small Business Administration's name came into the picture. With the help of a young loan officer at the West Port Plaza Bank, Gary O'Neal, I applied for an SBA loan in the amount of $160,000.

Within a couple of weeks, the loan was approved. First of all, I was shocked as to the quickness in which everybody moved. And, again, the loan was approved in 1974. I opened my first Casa Gallardo Restaurant in April of 1975. It was so successful that I was able to repay my loan in full within 18 months.

While in the process of expanding the concept to a second and third location, a conglomerate by the name of General Mills came along and offered to buy the company with plans to expand the concept. After months of negotiations, I agreed to the sale; and Casa Gallardo became a subsidiary of General Mills. I remained president of Casa Gallardo to oversee its expansion. It grew to 38 restaurants and $60 million in sales, employing 3,000 people. These restaurants are located in the Midwest and throughout the Southeast.

My involvement with General Mills ended in 1986. Since then, I have opened other businesses with my partner Pat Hanon. He was an employee at the Henry VIII Hotel at the time, and I talked him into joining me to open the first restaurant, Patrick's, in West Port Plaza.

Now, at that time, he was making a six-figure salary being the general manager of food and beverage at the Henry VIII Hotel, so he took a big chance in quitting his job and joining me in the venture of owning Patrick's Restaurant.

After that partnership with Patrick's, we went on to open other businesses; and we currently jointly and/or individually have opened the following restaurants: Patrick's—two Patrick's Restaurants, Ramon's Jalapeno, Bevo Mill, Ozzie's Restaurant and Sports Bar, Joe Hanon's Restaurant, and the Radisson Hotel. We are also part owners and on the board of directors of the Commercial Bank of West Port, which has assets of $60 million.

These establishments generate approximately $20 million in sales annually, employing over 1,000 people excluding the Commercial Bank of West Port.

It is hard to imagine that all of these started with one small $160,000 loan mostly guaranteed by the Small Business Administration 20 years ago. The SBA continues to help small businesses to secure the necessary capital needed to stimulate the economy and provide additional employment.

The Small Business Administration's confidence in my Mexican concept changed my life and, in turn, altered the lives of many other people. Several have called this the "American Dream". I call it a miracle, because I do not believe that this would have happened in any other place in the world other than this great country.

Anything I can do to support the Small Business Administration will never be enough for all that it has done for me and my family.

So, Mr. Chairman, I strongly thank you for this unique opportunity to allow me to express my views on behalf of the SBA. Thank you.

Chairman BOND. Thank you very much, Mr. Gallardo. Ms. Kirkpatrick.

**STATEMENT OF C. VIRGINIA KIRKPATRICK, OWNER, CVK PERSONNEL MANAGEMENT AND TRAINING SPECIALISTS, ST. LOUIS, MISSOURI**

Ms. KIRKPATRICK. Thank you. I represent myself as a small business person with a company that is about 12 years old, CVK Personnel Management and Training Specialists. I am also the training director for a joint program by the National Association of Women Business owners and the SBA, where we raise private funds to train women entrepreneurs in the St. Louis area.

I am also director for Allegiant Bank, which is a community bank with assets of $210 million. We have also made about 20 SBA loans in the last year; we are very active in the LowDoc program.

And I am also on the board of St. Louis Steel Products, a company which reopened Missouri Rolling Mill after it had been closed and then moved to Hazelwood with the help of a 504 loan and employs about 40 people; it is about $12 million in revenue. And that company also received help after the big flood of 1993 with the flood program through a low-interest loan.

I am also Chair of the Capital Formation Committee of the Missouri Delegation to the 1995 White House conference. So my knowledge is really a first-hand knowledge of how the SBA programs have worked.

I do not have to build a case for the need for small businesses to be able to get money. I think that has been adequately made here. Nor do I think I have to remind everyone that small businesses were creating jobs when large companies were laying them off. I believe seriously that without programs like the 504, the 7(a), the LowDoc program, the women's business loans, that many banks would not make those loans.

In a small community bank like Allegiant Bank, we are able to make an SBA loan, sell the guaranteed portion of that loan in the secondary market, and use that money to make another loan. So it helps our liquidity position a great deal when a small bank has limited amounts of money to loan.

From the grass roots level, I think that the LowDoc program was one of the most successful programs I have seen. Let me just give you an example. Working with the NAWBO–SUCCESSavvy and SBA training programs and counseling program, Gertrude's Beauty Salon, which is located in North St. Louis at 5367 St. Louis Avenue, was able to obtain a LowDoc loan to finish renovation of two buildings in an area of St. Louis that very definitely stands out in those two new renovated buildings.

Joyce Sullivan took over the family business after her sister was shot by a random bullet coming through a kitchen window as she was sitting at the table helping her children with their homework. So she was forced into that position; and as she came in, she dreamed that she might be able to renovate the buildings and grow the salon and employ more people and open a beauty products business which would be minority-run.

But when she went to the bank, they said: You have a credit problem. Because you do not have a good credit background, we are not going to be able to make you a loan. She was referred to us at the NAWBO–SUCCESSavvy training program. I was able to help her get a small loan to finish the renovation in the beauty salon; and then when the LowDoc program was announced, she was able to get a $50,000 loan.

I realize that these are small amounts of money that I am talking about, so it does not sound the same as venture capital. But to a family and to the 10 people who work there, those are opportunities that would have been lost without that opportunity.

I certainly believe that help at the right time is extremely important for small businesses; and I think that without such programs such as SBA and certainly without the help that the SBDC gives and that the NAWBO–SUCCESSavvy training program gives, some people would not be able to know even what to do and would be very despondent, I think, when they cannot get help.

I believe the national budget should be balanced, and I certainly do not have all the answers. But I am very concerned that we— that we not have a transition period, where we can plan and work to cover for areas that are being taken out of the budget. I think that the SBA has worked best in the field, not in Washington. I think when you begin to think about taking people out of the field who work at the grass roots level, something has to take its place.

So I appreciate the opportunity to give you some background, and I certainly hope that any transition that is made is going to be orderly enough that we do not destroy the help that has been available to small businesses.

[The prepared statement of Ms. Kirkpatrick follows:]

SENATOR BOND'S OFFICE
SMALL BUSINESS COMMITTEE HEARING

Testimony of C. Virginia Kirkpatrick

| | |
|---|---|
| *Owner:* | **CVK Personnel Management & Training Specialists** Founded in 1983: Consult primarily with small businesses in Human Resource Management field: Provide consulting services in all areas of HR Management; write supervisory manuals and provide training for supervisors; develop policies, procedures and programs to utilize human resources more effectively. |
| *Training Director:* | SUCCESSavvy Training Program conducted in St. Louis Metropolitan area with funding assistance of the Small Business Administration. Conduct training classes and consult with women who want to start or grow a business. Approximately 300 women go through the program annually. |
| *Bank Director* | Investor and director of Allegiant Bancorp which has five banking locations in Missouri - a small business with approximately 210,000,000 in assets. Member of the executive loan committees of the St. Louis Bank. |
| *Board Member & Director* | St. Louis Steel Products, Inc. A St. Louis manufacturing company employing 40 people. Reopened closed company - Missouri Rolling Mill and were able to make move when forced out of the city by "shopping center," reopened a GM plant using the SBA 504 loan program. The company also received a disaster loan following the big flood of 1993. |

*Chair of the Capital Formation Committee of the Missouri Delegation to the 1995 White House Conference on Small Business.*

My first hand knowledge of the SBA has been through the direct loan and loan guarantee programs, as well as through the training program we are able to provide for women who want to open or grow a business in the St. Louis Metropolitan area.

I don't believe I have to build a case for importance of available capital to meet the need of small businesses; nor do I need to establish the importance of small businesses to our economy. The recovery is still new enough for all of us to remember that large corporations were laying off people and small businesses were creating all the new jobs. High unemployment may be just a memory to some, but to the unemployed, it will never be forgotten!

From my experience on a loan committee reviewing and approving loan requests, I know that many loans to small businesses are more attractive to the bank because of the SBA guarantee. The ability to sell the guaranteed portion of the SBA loan on the secondary market is an added attraction for banks making SBA loans. And, private investors are more willing to invest in a small business when they know that capital for expansion is obtainable from the bank. That's how the capital is formed!

From the grass-roots level, the Low Doc Loan Program was extremely helpful and successful if its purpose was to encourage economic growth. An example may illustrate better than words how helpful the Low Doc loan program has been:

Gertrude's Beauty Salon is located in North St. Louis at 5367 St. Louis Avenue. The salon has been at that location for 30 yrs. and was started by Gertrude Mooring. As Gertrude's health failed, her daughter took over the operation of the salon. After that daughter was shot by a stray bullet which entered thru the window and killed her as she sat at the kitchen table helping her children with their homework, Joyce Sullivan had to step in and run the family business.

Joyce had dreams for renovating the two buildings owned by the family, growing the salon and establishing a minority owned beauty supply business in the second building. With her savings of $30,000, she started the renovation. When all her money was gone, and the job wasn't finished, she came to the bank to get a loan. Since she had a blemish on her credit record which was a carry-over from her recent marriage and the credit problems they had, Joyce was not eligible for a loan.

The bank referred Joyce to me and the NAWBO-SUCCESSavvy Program. She was very discouraged and felt all she had tried to build would be lost. By agreeing to guarantee a loan, I was able to help Joyce get a small loan to finish the renovation. After the Low Doc Loan Program became available, Joyce applied using her renovated buildings and revenue stream as collateral and was able to get a $50,000 loan to finish the building and start the beauty supply business. Both businesses together will employ about 10 people.

Help at the right time helped to keep a family business going, provide employment to 6 people and renovate two buildings which became a bright spot in a critical area of the city where decline and decay is the norm. I continue to consult with Joyce when she needs my help. I don't believe she would have been able to continue without some guidance and assistance.

I can give other examples of how the SBA Loan Programs have worked for small businesses and especially for women owned businesses if time permitted.

I believe the national budget should be balanced; however, I don't believe that will happen by destroying the vehicles and means of assistance provided by the SBA Loan Programs. Loan guarantee programs are not "give-aways," they are at the heart of capital formation made available to small businesses - and small businesses provide jobs and income for people who in turn pay taxes to support the government.

The SBA works best in the "field," not in Washington. I sincerely hope that Congress and the President will preserve the "grass roots" assistance provided to small businesses (including women owned businesses) by the SBA.

Chairman BOND. Thank you very much, Ms. Kirkpatrick. Let me ask all of the witnesses to comment on that. Currently, the top interest rate on the SBA loans is prime plus two and three quarters percent. Now, compared to other asset-based lenders or commercial finance company sources, do you feel that you could have gotten your start if there had been a higher charge for an SBA loan or a higher interest rate or more upfront fees? Would that have—well, let me start with Ms. Greenspan.

Ms. GREENSPAN. Well, more upfront fees? I run a business that has a very small markup; so when we are talking about more upfront fees, no, I would say not. As far as my paying—Are you saying me paying?

Chairman BOND. Yes. Somebody has to——

Ms. GREENSPAN. Right.

Chairman BOND. This is one of the proposals SBA has made to increase the fees and the charges both on the lenders and on the recipients of the loans.

Ms. GREENSPAN. Well, I think if you have to—if there is no other source, then you would have to; but I think it would be detrimental to many businesses.

Chairman BOND. If there had been a fee, as has been suggested, for the work—the assistance of the SBDC, which you highlighted as being very important, do you think you would have been able to come up with that fee?

Ms. GREENSPAN. Well, I possibly could have, but there are many that could not.

Chairman BOND. Mr. Gallardo, what do you think about these reform proposals?

Mr. GALLARDO. Well, I think that this fee could be built into the overall loan and paid over time.

Chairman BOND. Uh-huh.

Mr. GALLARDO. I think that would probably be the easiest way for somebody starting out a business to pay. On the other hand, if worse comes to worse, I think when somebody starts a business—I was willing to pay an individual that would give me a loan, 4 percent of the overall loan just so I could get that loan. And as a matter of fact, that is how I happened to find out about SBA. He was going to help me along to SBA. Then when I found that out, I went over to apply myself.

But nonetheless, I was ready to pay that 3 to 4 percent because I was so desperate to get that loan, being that I was not able to get it anyway.

On the other hand, I suppose when you talk about fees made to the lender, you said, again, I think that if those fees were to be spread over the life of the loan, I do not think that would be overly critical to the lender.

Chairman BOND. You were not able to get private sector funding then in 1974? You could not find any place to get that?

Mr. GALLARDO. No.

Chairman BOND. Do you see any changes in the market that might make lenders more likely to lend to start-up businesses, to entrepreneurs? In other words, do you still feel, notwithstanding the concerns raised by those who argue that the rest of the businesses are subsidizing 1 percent, do you still feel that there is——

Mr. GALLARDO. I do not think that I see any change, particularly in my industry. Because when somebody approaches a bank, the bank wants the collateral. There is no question about it.

And as far as the restaurant, the collateral is so untangible because of the license and use improvements. And, of course, a lender cannot recoup, cannot resell those loan improvements should the loan go into default. So it is extremely difficult to find the loans out there to build a restaurant. Even if you have 50 percent of the overall capital, I doubt very much that a bank would lend 50 percent on these loan improvements and equipment.

So, yes, to answer your question.

Chairman BOND. Ms. Kirkpatrick.

Ms. KIRKPATRICK. Well, I see that fees rolled into the total loan proceeds paid back with the interest and principal of the loan are very feasible. I think that if you said to Joyce Sullivan "you have got to have fees of 2 to 3 to 4 to $500 or you cannot get this loan", that is prohibitive. That will not work. But I think fees rolled into the total proceeds of the loan would work and are feasible.

Chairman BOND. One of the suggestions that has been raised, I believe, by some of the people working on the White House conference group was to privatize the SBA loan function. That has been suggested before along the lines of Fannie Mae or Freddie Mac. Have you been involved in those discussions?

Ms. KIRKPATRICK. Yes.

Chairman BOND. What are your views on those?

Ms. KIRKPATRICK. Well, I think that is difficult to look at. I think it could be done, and I think that we have a model to follow in order to do that. My concern is that that is going to take some time and that it sounds like in Washington we are looking at we have to do it tomorrow. So therefore, all of a sudden there is not going to be anything, and there is going to be kind of a void.

In the long run, I think it could be done; and we are going to certainly come up with a resolution at the White House conference to that end.

Chairman BOND. Do you think without the collateral—I guess the big question in the lack of collateral is the common feature. If you tried to securitize a portfolio of small business loans, do you see that package beingsaleable when the purchaser has to bet on the success of enough of the businesses to cover the failures on others where there is not collateral?

Ms. KIRKPATRICK. No, I do not. I think that—that the reason you can securitize a loan is because of the guarantee for some portion of that loan, not because of a collateral that is there. Because that is really one of the typical things that small businesses—especially women-owned businesses—in start-up phase or even in growth phase often do not have the collateral to back up the loan.

And at St. Louis Steel Products, if it had not been for the guaranteed portion of the loan, there would not have been private investors who were willing to put their money into that as well. So I believe there has to be some sort of guaranteed portion.

Chairman BOND. Mr. Gallardo, you have obviously become very sophisticated in finance.

Mr. GALLARDO. Oh, no. No. [Laughter]

Chairman BOND. What is your view of the possibility of securitizing loans and really moving the SBA out of the direct guarantee process? Do you think a securitized portfolio could be saleable?

Mr. GALLARDO. Well, again, I think that Fannie Mae is an example of that; but I think it could work. And I guess it would be—are you saying it would be taken out of the government's hands and be in the private sector? But likewise, I agree with Ms. Kirkpatrick that we need an answer today. And I think that we hate to jeopardize the SBA and we understand that we need to balance the budget and what have you; but, my God, the SBA has been such a key element in creating so many businesses in general.

Chairman BOND. Ms. Greenspan, any comments on that?

Ms. GREENSPAN. Well, personally, I could not have gotten a loan unless the SBA was backing me. That is my personal opinion. I had some collateral but not enough to warrant $40,000.

Chairman BOND. Well, again, my sincere thanks to all of the members of this panel. This is a question that obviously is going to be considered at the White House Conference, and we will look forward to hearing your work at that conference. And also we welcome your comments as this discussion continues, as we see how various reforms would work and what might be the best means to assure that that patient long-term capital continues to be available; which certainly, I think, is of vital importance. Thank you very much.

Now, I would like to call forth Robert James Cimasi, President of Health Capital Consultants; Professor Murray Weidenbaum, Chairman of the Center for the Study of American Business at Washington University and the real expert on the issues of regulation and economy; and Dr. Robert H. Brockhaus, Director of Jefferson Smurfit Center for Entrepreneurial Studies and the Coleman Foundation Chairholder.

Welcome, Gentlemen. We are delighted to have all of you with us. Let's start with Mr. Cimasi.

**STATEMENT OF ROBERT JAMES CIMASI, CBI, CBC, PRESIDENT AND FOUNDER, HEALTH CAPITAL CONSULTANTS, INC., ST. LOUIS, MISSOURI**

Mr. CIMASI. Senator, thank you for the opportunity to address you today. My name is Robert James Cimasi. I am president and founder of Health Capital Consultants, a health care consulting firm of approximately 20 employees headquartered here in St. Louis, Missouri. I believe that some of the budget cuts and restructuring being proposed for the Small Business Administration may result in a negative impact on job growth on the U.S. economy.

The SBA provides guarantees to lenders on loans they make to small businesses. We know that small business dominated industries accounted for 71 percent of the jobs created between June of '93 and June of '94 and that the service sector of small businesses has experienced the greatest growth.

Overall, businesses that have employed less than 20 people, and that is 85 percent of all businesses in the U.S., create more jobs than the Fortune 500 companies. So even with the slowing growth of U.S. economy, small businesses continue to be a significant driving force behind the expansion of job opportunities with the service sector continuing to lead the way.

Often, those service sectors of small businesses find it difficult, if not impossible, to obtain from private sector lending sources, the capital needed to sustain their growth or finance their expansion. The expansion they need to remain competitive in the market. Even after two to five years of operation, many service businesses will have operated successfully but not yet thrown off sufficient excess cash flow to internally fund necessary investments to meet the demands of their market.

Commercial lenders in the private sector typically offer asset-based lending programs that are designed to fit the program of a small business with a significant tangible or hard asset base. Significant hard assets are not a characteristic that is often found in small service section businesses.

Service businesses require capital to invest in people, their employees' education, their training, their technical skill-sets, and the professional development that is a service business engine for future growth and improved productivity. These people-oriented, employment-focused investments are both intangible and are often, by nature, a long-term investment, the benefits of which may require a longer period of time to be fully realized than a similar investment in hard assets.

If we invest in a drill press or pallet machine, that investment is placed on the balance sheet as a hard asset. If we invest in a graduate student with a master's in health administration from the University of Missouri or Washington University, the investment in their professional development is often not listed on the balance sheet.

At the same time, service sector small businesses do not have the same type of access to the capital markets of Wall Street or investment bankers or venture capitalists as do larger businesses; and those that do turn to the equity market or seek financing from venture capital may often find their plans for continued long-term growth are complicated or thwarted by demands for more immediate returns on investment.

Our firm works within the health care industry, an industry that represents fully one-seventh of the U.S. economy. We are experiencing dynamic, almost turbulent, changes in the health care system. In the new health care paradigm, cost containment measures and other market forces are driving a massive movement from inpatient services to outpatient and ambulatory care services as well as a significant growth in the home health sector.

This is both a challenging and exciting time in health care, a time that is both compelling the significant consolidation and restructuring of traditional provider entities, and at the same time providing almost boundless opportunities to start-up small service sector businesses. As hospital consolidations and mergers force layoffs and significant reductions in the number of service jobs, the importance of new start-up businesses and the expansion of established health care service sector businesses become all the more important to pick up the slack in employment.

The capital formation needs of these small service businesses are not likely to be met through private sector commercial lending sources or other sources related to the venture capital and equity markets. It is in this area and for these reasons that the loan guarantee programs of the Small Business Administration are most vitally needed and must continue.

To be most effective, the total financing of the SBA should be expanded, not reduced. The growth of small businesses and their expansion of higher-paying jobs allowed through SBA programs has historically been a successful investment for the United States taxpayers. It is an investment that should be continued and should grow.

The loan application and origination process should continue to be simplified and expedited, and I believe significant gains have been made in this direction over the past several years through efforts such as the LowDoc program and the Preferred Lender Status program that the SBA has put into place. The SBA lending programs should avoid, if possible, raising barriers to the program such as charging lenders, and thereby borrowers, with higher guarantee fees or annual points on outstanding loan balances, because the impact on service sector small business borrowers may be to shut them out of the program at a time when the U.S. economy needs to have these businesses aggressively pursue more growth, more expansion, and higher paid salaries; not less.

Finally, while some adjustments and revisions in some specific areas within the SBA's range of programs may need to be addressed and revised, the overall intent of the program should be preserved and enhanced. SBA programs make sense for small businesses. They especially make sense for small service sector businesses which are still driving job growth, better paying job growth, even in a slow U.S. economy.

SBA programs make sense for the U.S. taxpayer because the programs work by helping to put U.S. taxpayers to work. SBA programs are proof that not all of government is bad. As one of the smallest agencies in government, the SBA operates, in effect, as a profit-based business itself, creating jobs and taxes and allowing American taxpayers to make a profit on the programs.

Senator Bond, I urge you and your colleagues to support and enhance the SBA's important role for small business in America. Thank you.

Chairman BOND. Mr. Cimasi, I am glad to hear the power the government has had. It is kind of a relief. [Laughter.]

But now it is a real pleasure to turn to an old friend, Professor Weidenbaum. Welcome.

**STATEMENT OF PROFESSOR MURRAY WEIDENBAUM, DIRECTOR, CENTER FOR THE STUDY OF AMERICAN BUSINESS AT WASHINGTON UNIVERSITY IN ST. LOUIS, MISSOURI**

Professor WEIDENBAUM. Thank you, Mr. Chairman. It is a real pleasure to be here. And, yes, I am the heavy that you quoted earlier.

Chairman BOND. I figured you could handle it. I thought I would let them get their cracks in so you could answer when you came.

Professor WEIDENBAUM. Thank you, sir. And it is true that most small businesses do not get any benefit from the SBA, but that is not the point I want to make primarily. It is that small business has a rough time getting capital financing. You have to ask, though, "Why?"

Well, it turns out, among a number of concerns, the Treasury takes off the top the great majority of all the investment capital generated in the American economy each year. So if you really want to benefit not the 1 percent but 100 percent of small businesses, the obvious thing to do is to reduce those triple digit budget deficits. And that is where the problem arises.

As you may know, I literally grew up in Harry Truman's Budget Bureau, so I have been witnessing how budgets grow over the years. And unfortunately, no disrespect to my fellow witnesses, but what we have seen here is typical. Every time the Congress tries to cut any government spending program, the people who benefit from that program come in en masse and say: This is a terrible thing you want to do. This is a valuable program. Why don't you cut the other fellow's program that is full of waste, fraud, and abuse or whatever?

Well, every program has its beneficiaries. The result is the awesome budget deficits that we get today. The National Federation of Independent Business took a very recent survey of small businesses, asking them: What are the serious problems on your mind? The lack of government subsidy, a lack of government help was not on that list. On top of the list was high taxation and high regulation, and those are two things that are the responsibilities of the federal government.

That is why I urge you, Mr. Chairman, and the members of your committee to seriously consider what government could do to reduce the burdens of small business; not the relatively few lucky ones who benefit from the SBA programs, but the whole array of the millions—literally the millions—of small businesses.

Because if you look at government in its role of helper of small business today, what I find very frankly is the phenomenon of something like the dumb motorist who has one foot on the gas pedal and the other foot on the brake at the same time. The advice obviously is if you want to move ahead, get your foot off the brake. And unfortunately, it is the heavier pressure of the government that is on the brake these days; so that no doubt it is going to be rough on the beneficiaries of SBA if you tighten the belt by cutting their budget along with the budgets of all the other federal spending agencies.

But that is how you truly will help create a vibrant growing small business sector. Thank you very much, Mr. Chairman.

[The prepared statement of Professor Weidenbaum follows:]

## Government Policy and Small Business Financing

by Murray Weidenbaum

Federal government policy for financing small business reminds me of the motorist who puts one foot on the gas pedal and, at the same time, puts the other foot on the brake. I'll explain the situation briefly and then show a way out of this dilemma.

### Background

First of all, the sad fact is that new and small businesses are the marginal borrowers in the U.S. economy. They are always hurting for financing. In contrast, General Electric gets the funds it needs; sometimes it has to pay more. But especially during times of tight credit, Specific Electric gets rationed out.

Unfortunately, current government policy makes this situation more difficult for small business. For example, Treasury financing of huge budget deficits drains away a large portion of the funds in capital markets, making even tougher the competition for the remaining funds. High tax rates reduce the amount of retained earnings that can be reinvested, reinforcing the dependence on borrowed money. High capital gains taxes discourage potential investors in risky new and small companies. In addition, a wide array of regulation and mandates make it less likely that the small enterprise will make a go of it in the first place.

There literally are economies of scale in complying with government directives. Giant General Motors pretty much fills out the same forms and meets the same requirements as small Specific Motors. The result is that the cost of regulation is a much higher percent of sales for a small company than for its larger competitors.

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Murray Weidenbaum is Director of the Center for the Study of American Business at Washington University in St. Louis. This text is from his testimony to the U.S. Senate Committee on Small Business on April 12, 1995 in St. Louis. The views expressed are his own.

While regulatory flexibility was supposed to provide small business relief in this area, little relief has actually taken place. In some instances, small firms are exempted from reporting requirements, but these are the exception and not the rule. Ironically, even this relief can work against small firms, placing a "glass ceiling" over their employment growth in order to avoid the high regulatory costs that kick in with the fiftieth employee.

There is good reason for focusing on taxation and regulation. The recently released survey by the National Federation of Independent Business shows that small companies believe that, by far, taxes and regulation are the two most important problems facing them.

## Changes in Public Policy

It is not surprising, in light of this situation, that the federal government is continually being urged to do something special for small business. That is the basic justification for the expenditure and credit programs of the Small Business Administration. Frankly, there is a basic problem with pushing that approach too far. Specifically, less than 1 percent of the millions of small companies ever receive an SBA loan. The other 99 percent pay the taxes to support the program. Moreover, given the deficit problem, every dollar for a higher SBA budget means another dollar not available in private credit markets.

What should be done? The federal government should take its big foot off the brake. It needs to reduce the deficit, reform the tax system, and streamline government regulation. Progress on these three fronts will do far more to ease the financing burden on small business than any special purpose legislation aimed to help small companies.

I'd like to offer a few comments on each of these points. As an old budget cutter, I remember Harry Truman saying that he never saw a budget that could not be cut. In that spirit, no federal program should be "off the table." Congress should look for soft spots in every department and agency — with no exception.

As for tax policy, we need genuine tax reform. Senators Pete Domenici and Sam Nunn have been developing a savings-exempt income tax and a companion business cash flow tax. Their proposal eliminates 80 percent of the provisions of the income tax law and relieves the tax burden on saving and investment.

As for regulatory reform, the requirement for benefit/cost analysis now being considered by the Senate is exactly the medicine this doctor ordered. Rules that generate more cost than benefit do not make sense.

These three sets of actions are needed to create the economic conditions whereby small companies can generate and attract the capital that they so badly need.

My final point is the standard advice that I give to congressional committees, "Don't just stand there, undo something."

Chairman BOND. Thank you very much, Professor. We did hold a hearing this morning in Kansas City on regulatory burdens, and we will be holding one tomorrow in Memphis and tomorrow afternoon in Cape Girardeau. Cape Girardeau will be featuring agribusiness and regulatory burdens. But dealing with the burdens the government places on business is going to be one of the functions that we will pursue in this Committee.

Well, Dr. Brockhaus, you have had the benefit of all of the testimony before you, so I am sure you can tailor your remarks to deal with all of the questions that have been raised.

**STATEMENT OF ROBERT H. BROCKHAUS, PH.D., COLEMAN FOUNDATION CHAIRHOLDER IN ENTREPRENEURSHIP, AND DIRECTOR, JEFFERSON SMURFIT CENTER FOR ENTREPRENEURIAL STUDIES, ST. LOUIS (MISSOURI) UNIVERSITY**

Dr. BROCKHAUS. Thank you, Senator. I do want to apologize up front for the brevity of my comments. I did not learn of this until Monday afternoon.

Chairman BOND. I know of your long-time work in this area, and we are very delighted you could join us.

Dr. BROCKHAUS. Well, thank you. To my esteemed colleague, Dr. Weidenbaum, being in his institution as his guest today, I should be very polite to him. But as an alumni of Washington University where I earned my Ph.D. in a building right across the way, I imagine he should be very nice to me. [Laughter]

I did establish the Missouri SBDC program, as you know--you were at our dedication—which I served as the state director on an interim period. I also served as the national president of the Small Business Institute. A number of people may not be familiar with that program, but that is where university students provide free one-on-one consulting to various small businesses.

I have been a delegate to the 1986 White House Conference on Small Business and will be going again this summer as a delegate from Missouri.

I share the concerns and agree with Professor Weidenbaum that the interest on the national debt acts as a foot on the brake pedal. That is something that I think is very, very, very detrimental to the long-term growth and vitality of the small business and entrepreneurial communities in this country.

But the foot is on the brake; and until somebody really takes that brake off, the small businesses are the ones who feel the pressure of that brake the most. There needs to be some type of release mechanism. And that is what I see the current SBA financing and management assistance programs doing today.

But I would like to address these issues in a more general sense, if I might. Venture capital is an area that has received a lot of interest; but I do not think too many people realize that less than 1 in 1,000 small businesses in the start-up phase receive venture capital from formal venture capital firms. More venture capital is provided through informal private investors—wealthy doctors, retired entrepreneurs, etc., who seek to invest in someone else's business. Approximately 12 in 100 start-up businesses receive this type of informal capital which accounts for about 18 percent of the capital they receive.

When businesses are small, many get funding from the type of SBA programs we have heard described earlier this afternoon. The venture capital firms come in when the amount of money that a business needs typically is $1 million or more. But there is a gap that exists from around $500,000 to $1 million. Those gaps vary by industry and by particular circumstances of the business.

But that is a general area where it is very, very hard to generate funds if you are growing a successful business. You probably have gotten all of the funds available from friends or relatives for equity investment. Banks say you have too much debt compared to the amount of equity you have, so they are not interested in funding you. The venture capital people can manage one large investment easier administratively than two or three smaller investments, so they are not interested. That is a gap that is very hard for the growing businesses to jump.

The people who have provided most of the money for this gap are informal private investors—or angels, as they are referred to. I believe that is an area that receives insufficient attention today. There are tax incentives that could help encourage more of these types of people to become involved. Indeed a marketing effort to match those businesses that need this amount of money with people who are willing to invest these amounts could greatly benefit growing businesses.

Finally, I would like to talk a little bit about the role of venture capitalists after they make investments. Out of 10 investments that venture capital people do make after a great deal of due diligence and careful analysis, 2 will fail; 5 out of 10 are going to sort of break even—they never make a lot of money; they never lose a lot of money—2 out of 10 are fairly profitable; and the profits of those pretty well offset the losses of those that failed, leaving only 1 out of 10 that is very profitable.

So venture capitalists, while we may think of them as “vulture” capitalists at times, really do have a position that is not as lucrative as many of us might think. Their position on the boards of directors of these growing organizations can be useful. Typically, venture capitalists plan for their investments to last from five to seven years returning in some form after that.

Entrepreneurs believe the nonfinancial value of this advice is a mixed blessing. Some believe venture capitalists have provided useful, helpful information. Others do not think they added that much to the management of the business.

One last comment, Senator, you raised the question about the 1 percent who receive SBA assistance versus the 99 percent who do not. That reminds me of the olden days when an army would be going into battle. In front of that army was someone carrying the flag, the standard symbol of that country or that army. They did not have a gun, they did not have a sword; but they were there representing and encouraging those who were behind. That is the role of the SBA and some of the programs that we have heard discussed this afternoon. That they are standard bearers; they are the ones who are encouraging that other 99 percent to follow.

I firmly believe in what the SBA programs can offer. I know personally, having been in the administrator’s office more than once in Washington, that there is an opportunity for significant improvement in the administration of the SBA both nationally and nationally on a local level. But the image and the importance of the SBA organization is very important to our entrepreneur businesses. Thank you.

Chairman BOND. Thank you very much, Dr. Brockhaus. Mr. Cimasi, we are going to have to make some cuts, and we will make some cuts, in the Small Business Administration funding. And I think you said that you felt that raising the fees at the front end would have a harmful effect on the businesses that need this capital. What would you suggest? Where can we make savings? What can we do to take care of the need that you see but reduce the commitment of taxpayer dollars?

Mr. CIMASI. Senator, if those costs can be built in at the end of the loan, that might help—or spread out over that period of time. But I think there are some programs in place that might be the key to that. First of all, I think that the Preferred Lender program and cutting back the amount of paperwork, I think the consolidation of offices, is maybe not a bad idea. In the days and age of overnight couriers and fax machines and those types of things, perhaps not as many offices are going to be required. Having local institutions do a lot of the loan origination may cut back on costs.

Ultimately, though, I think it is better to shrink the costs of doing that than to allow the costs to remain the way they are and then pass those on to the folks that need the capital. Because I believe that raises a barrier that prevents some of them from being able to utilize the loan.

Chairman BOND. What would you say in response to Professor Weidenbaum's testimony about the need to get all of government spending down and that would thereby release the capital needed in the private sector to take care of the kinds of businesses that you have described, particularly in the service area?

Mr. CIMASI. Senator, in all due respect to the Professor's comments, all of us would like to see the burden of government taxes taken down, and all of us would like to see more capital awarded to small businesses as opposed to paying off the deficit. I will say though that I do not have an SBA loan for my firm, but I do not begrudge—and I pay taxes—I do not begrudge the firms that do because I do business with them and they generate jobs and there is a ripple effect that goes through the economy.

So the response of that is, clearly, if we can cut the costs of the program down and not raise barriers, I would do that; if we can make more capital available by lessening government, I think all of us are in favor of that. I think specifically though that I look at it as saying this is generating new businesses and hiring new people; it is creating more opportunity for my firm that would not be there had the SBA not been there to help these folks form their venture. I do not mind paying that—whatever small amount of taxes we all do to support that 1 percent.

Chairman BOND. Professor Weidenbaum, what do you think of utilizing—if we cut back on the dollars—utilizing the government's intermediary role in providing and bringing lenders and borrowers together? Is there a way that we can appropriately, in your view, utilize the mechanisms that have been developed in the SBA programs?

Professor WEIDENBAUM. Well, I am not terribly enthusiastic, very frankly, about the prospect of, say, expanding the SBIC approach or the general notion of using the government's credit power. When I hear that banks are willing to loan money to small businesses, all they need is a 50, 70, 90 percent or whatever guarantee from the government, that tells me if the government takes the risks, they are willing to administer the program.

Well, I think we have to look at the totality of the private enterprise system and see not just the immediate direct results of a government spending program, but step back and see how the entire private enterprise system is truly being devastated by a budget deficit that preempts the great majority of the private capital.

The trouble is, you can see, yes—as my fellow witness knows very accurately—you can see the whites of their eyes; you can see the benefits that you get from dealing with an SBA benefited business. But you cannot see the businesses that have not been formed, the businesses that fall by the wayside because the cap—so much of the capitalists of this nation has been preempted by the federal government. And the notion that you can exempt the SBA from the effort to reduce the deficit and take it out of all the other spending programs, I think, very frankly is a delusion.

Yes, I do sound a negative cord. As you know, my advice to congressional committees over the years has been: Don't just stand there, undo something. And very frankly, I think this is a very attractive example of the opportunity.

Chairman BOND. What would you say——

Professor WEIDENBAUM. I do——

Chairman BOND. Excuse me. What would you say to the suggestion that we mentioned to the earlier panel that we try to privatize the SBA and go to a Ginnie Mae or Freddie Mac type operation to securitize loans?

Professor WEIDENBAUM. The general notion of privatization, of course, I find very attractive. They are talking in those instances in the housing area of privatizing loans with a very substantial government guarantee on them. So the government is still bearing most of the risk.

If you can privatize the portions of the SBA operation without the government still taking on most of the risk, I think that is a very attractive opportunity. And perhaps a straightforward privatization of SBICs and other SBA functions ought to be attempted.

Chairman BOND. All right, sir. Well, I look forward to exploring some of those roles with you as we continue our discussions.

Dr. Brockhaus, let me ask your general views on that concept of reducing appropriated funds either by increasing fees or looking at privatization or perhaps even lessening the government's role, the government guarantee, in exchange for allowing the lending institutions to use their own paperwork. What is the best way to move in terms of making savings and still providing assistance that only government can provide to small businesses?

Dr. BROCKHAUS. Well, I do agree basically with the thrust that has been developed this afternoon in the sense that I think that many in the private sector recognize the importance of the reduction of the federal deficit and is willing to play a part in that. I think you heard that consistently this afternoon, or almost consistently.

It would seem to me that certainly fees for the loan processes, as they were proposed and talked about this afternoon, makes sense and would not put an undue burden on businesses if they were paid off during the process of paying off the loan.

Chairman BOND. Not paying up front?

Dr. BROCKHAUS. Not paying up front, but paying during the period of the loan. The same with services provided by SBDC. I think people pay more attention to something they pay a nominal fee for. There may be some exceptions that would need to be built into that, because I know that the SBDC has clients that come to it who really do not have very much cash to offer. It becomes a policy decision at that point whether we want to encourage those people who are that destitute to actually get into a business or not. I could argue that one either way.

I think that the SBDC has a role of helping businesses that are looking for international trade opportunities and are looking for technology expansion. Those are the types of activities that will increase the number of jobs rather than simply having the business currently going to company A going to company B, but without a significant net gain employment.

So I think SBDC should certainly have a role in technology and export work which our SBDCs in the State of Missouri do have.

Chairman BOND. To what extent are you providing general management, financing, marketing, production advice and counseling to these businesses—basic business advice?

Dr. BROCKHAUS. They receive all of those types of advice as well as technology advice. As you know, the SBDC does not do things for them; they help the entrepreneurs do for themselves by raising issues that they should be concerned about, having them develop a series of questions that they need to answer, and helping them understand where they can find the answers. But it is not a process that does it for the entrepreneur, which would be a disservice to the entrepreneur.

Similar to that is the SBI program which I feel encourages future entrepreneurs, as they help small businesses, to learn about what it is really like to own a business. Some students are discouraged by that process; they say: this is not the type of life I want. This is an important lesson to learn rather than after having a job for 10 years, deciding to start a business and then end up, after investing a great deal of time and money, failing.

I believe that the SBI program, which I know is eliminated from the SBA's budget at this point in time, is one that really helps provide future generations with more than just a passing awareness of entrepreneurship, its benefits, and its costs.

Chairman BOND. You mentioned the need for better management in the SBA. Are you talking about managing the agency itself or providing management expertise and advice to SBA clients?

Dr. BROCKHAUS. I was talking about the former. I have known at least one person who I considered a very, very good administrator, Jim Sanders. In my personal opinion, there have been some administrators who certainly did not do a very good job. I would hope that through the oversight responsibilities of your committee that more attention could be put on the type of person that the administration recommends for that key job as well as other key jobs in the administration.

In terms of the SBA itself, I think it is a good leveraging tool. I really do not believe that they should be doing much of the management advising and counseling. I think they can get a far bigger bang from their dollar through programs like the SBDC and the SBI program which generate more tax dollars than they cost.

Chairman BOND. That is one of the areas we are looking at. Gentlemen, again, my sincere thanks to all of you. We hope that we have broadened the discussion and raised perhaps some new issues for some of you. We would invite you to comment on those. We are most grateful for the time and effort that you put in to get prepared and come here today to testify. We will take all of this back to Washington and hope to gain direction, wisdom, and some good solutions to the problems we face from your testimony. With that, and my sincere thanks to all of you, this hearing is adjourned.

[Whereupon, at 3:30 p.m., the Committee was adjourned.]

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